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Published in:
Proceedings of the 23rd Asian Pacific on International Accounting Issues

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30 January, 2012

Paper Field – Corporate Governance

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ABSTRACT

This paper examines the interaction between corporate governance and earnings as they affect market performance. The research focuses on Chinese capital markets because of their unique characteristics with respect to elements of corporate governance. Specifically, Chinese companies may issue A-shares to Chinese citizens or B-shares to foreign investors and overseas Chinese or Chinese citizens with foreign currency. B-shares produce reports based on International Accounting Standards, have an independent board structure, and use international recognised auditor. Companies with A-shares only use Chinese Accounting Standards, do not have independent boards of directors and use Chinese auditors operating under Chinese audit standards.

The differences in governances characteristic between A-share companies and companies with AB-shares provides a useful site to test the relevance of international governance standards in a developing market. Specifically, a matched pair design using Event Study Methodology provides a comparison between the market responses to an earnings announcement where differences in governance practices exist.

The results indicate that the Chinese stock markets were segmented before the relaxation of restrictions on purchase of B-shares by domestic investors in 2001 and they remained segmented after the regulation change in 2001. Accordingly, the analysis of governance impacts was assessed in these two segments.

The results suggest that corporate governance does not effects market's reactions to earnings. Investors do not react differently to earnings announcements due to different accounting standards, board structure and audit quality. Contrary to expectation, the earnings response of AB-shares' is not significantly different from that of A-shares' earnings response. These findings imply that Chinese listed companies based on Western governance perform no better than Chinese listed companies based on Chinese governance, in terms of the market's reactions to earnings announcement.

THE EFFECT OF CORPORATE GOVERNANCE VARIABLES ON SHARE PRICE: A COMPARISON OF "A CLASS" AND "B CLASS" SHARES IN THE PEOPLE'S REPUBLIC OF CHINA

INTRODUCTION

Although much attention has been given to corporate governance in the United States and other Western countries ((Palepu 1990) (Abdel-khalik 2002) (Holmström and Kaplan 2003) (Volpin 2002) (Romano 2004) much has also been going on in Russia, East Asian countries, and other transition economies in the area of corporate governance (Black et al. 2006; Black 2001). This paper tests whether corporate governance impacts on the relevance and reliability of the accounting earnings information in the Chinese market The Chinese stock market provides a unique research site in because both western and local governance operate within the one market through its use of two classes of shares, A Shares and B Shares. A shares have Chinese governance and firms with both A and B shares have Western governance. This study uses event study methodology with a matched pair sample of companies with A Shares only (Chinese governance standards) and those with A and B shares (Western Governance). We find that Chinese A and B-share markets react differently to earnings produced under IAS, compared with earnings based on the Chinese GAAP.

The remainder of this paper proceeds as follows. The next section details the dual system of governance in the Peoples Republic of China (PPRC) - Western corporate governance for companies with A and B class shares and Chinese corporate governance for companies with A class shares only. Section three details the relevant theories of corporate governance which suggest that market performance of firms with Western governance should be greater than those with Chinese governance. Section four presents the hypotheses to be tested and the event study methodology to

OVERVIEW OF STOCK MARKETS IN CHINA

The history of stock trading in China can be traced back to the 1860s. The first share list appeared in June 1866 and came to an abrupt halt after Japanese troops occupied the Shanghai International Settlement on December 1941. On November 26, 1990, Shanghai Stock Exchange was established again and officially opened on December 19. Shenzhen Stock Exchange was established in early 1991.

China's stock markets at Shanghai and Shenzhen have features that differ significantly from Western stock markets. The most pronounced feature is the complicated structure of Chin's stocks, which are classified by accessibility into A-shares, B-shares, H-shares and N-shares. A-shares are available to Chinese residents and B-shares are also available to Chinese residents with foreign currency since 2001. A-shares and B-shares are listed in the Shanghai and Shenzhen stock exchanges. H-shares and N-shares are listed in Hong Kong and overseas stock markets. AB shares

are the focus of this research. A-shares prices fluctuate extensively and trade at a premium, relative to B-shares which are relative steady.

The key differences between A-shares governance and AB-shares governance are share structure, auditor independence, accounting standard and ownership of stocks. The differences in governances characteristic between A-share companies and companies with AB-shares provides a useful site to test the relevance of international governance standards in a developing market. Specifically, a matched pair design using Event Study Methodology provides a comparison between the market responses to an earnings announcement where differences in governance practices exist.

MODEL OVERVIEW

While there have been a large number of studies address the relationship between corporate governance and company-market performance, the results are mixed (Hutchinson and Gul 2004; Mukherjee 2001; Denis 2001; Bianco and Casavola 1999; Diacon and O'Sullivan 1995; Shrives 2004). Part of the problem with this research is the difficulty in designing an empirical test where the effects of changes in governance can be measured while controlling for other factors. The Chinese stock market provides a unique research site in that both western and local governance operate within the one market. Further, there exist different classes of shares within the same industry but that have different governance mechanisms due to the nature of their shareholding. This provides for a direct comparison of the effects of governance on firm performance.

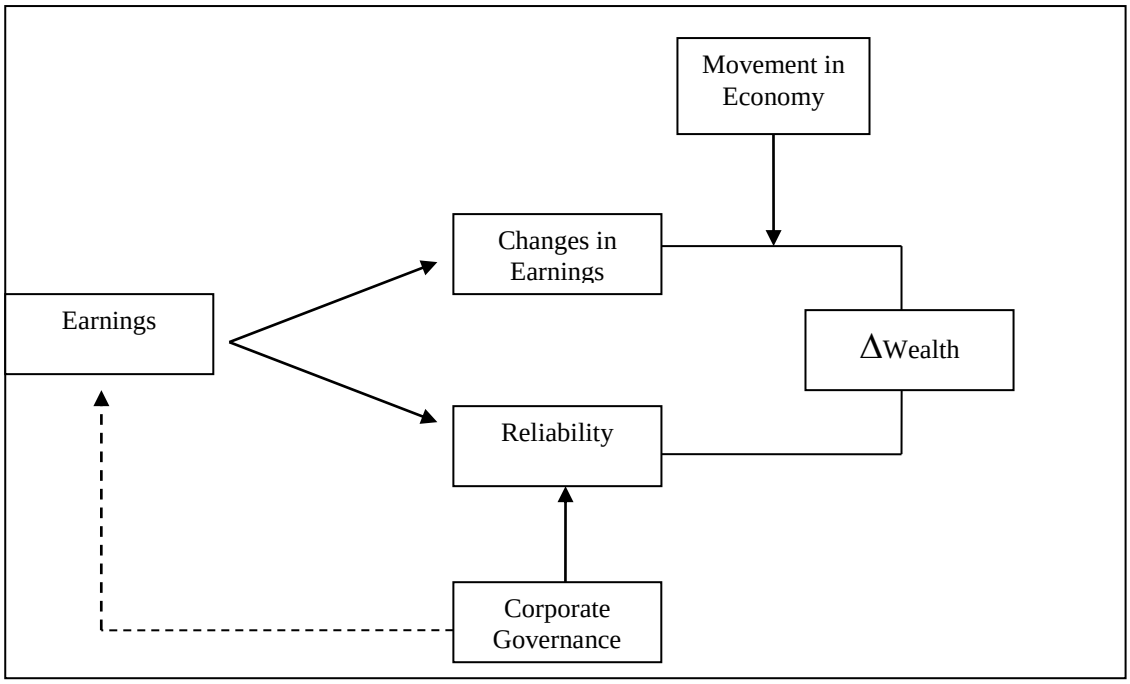
EARNINGS RESPONSE MODEL

While earnings is shown to have a positive association with market value (Ball and Brown 1968), this research argues for corporate governance playing a moderating role on the earnings value relationship. Corporate governance may increase the reliability of earnings, thereby increasing the value-relevance of earnings and/or it may impact on the level of earning of the firm. In other words, corporate governance may have a positive impact on the association between earnings and market value (Ball et al. 2000; Kormendi 1987; Dina F and Abdulatia 2006; Donnelly 2002; Ohlson 1983, 1995; Ohlson 1999).

The comprehensive literature on the positive impact on corporate governance on the firms suggests that these variables may have a direct impact on market value in addition to its impact on the reliability of earnings and book value. In this research, the impact of corporate governance on the company wealth is assessed as either a direct impact or indirectly via earnings.

Figure 1 provides a schematic of the relationship between earnings, change in earnings and reliability in affecting the company wealth.

FIGURE 1: EARNINGS RESPONSE MODEL



From Figure 1, both earnings and change in earnings are expected to have a positive association with return reflecting the value-relevance of the accounting measures.

The model suggests that corporate governance plays a moderating role, impacting on the association between earnings and returns. Thus, corporate governance plays a critical role, as an indicator of earnings reliability, between company's earnings and returns (Collins and DeAngelo 1990; Guercio and Hawkins 1999; Chen et al. 1999; Suk-Yee Lee et al. 2005; Black et al. 2006).

No finance theory provides a formal direct link between corporate governance and the share return. However, a number of studies have suggested such a relationship empirically by directly comparing the association between corporate governance and share returns (Jones 2004; Yoshikawa and Phan 2003; Salva 2003; Suk-Yee Lee et al. 2005; Bauer et al. 2003; Lemmon and Lins 2001; Nguyen and Aman 2006). In addition, other studies show that corporate governance impacts directly on accounting earnings and thus is indirectly linked to the changes in share returns (Xie et al. ; Collins and DeAngelo 1990; Bushman et al. 2004; Xie et al. 2003; Suk-Yee Lee et al. 2005; Alford et al. 1993; Anderson et al. 2003; Brown and Ngo Higgins 2001; Bauer et al. 2003) (Lawrence and Stapledon 1999; Hutchinson and Gul 2004; Bai et al. 2004)

The greater effectiveness of corporate governance should result in a greater return. Therefore a greater return should be derived from earning prepared under Western governance requirements compared to earning prepared under other governance requirements. If Western corporate governance requirements are universally applicable, including developing countries, then the

market response to earnings prepared under these governance requirements should be greater when other governance requirements used.

GOVERNANCE

A large segment of the corporate governance literature focuses on a direct relationship between corporate governance and corporate performance. Brown and Caylor (2001) demonstrate that corporate governance is strongly correlated with operating performance, valuation, and dividend payout for a large sample of US firms. Black et al. (2004) and Beiner et al. (2004) indicate that the direction of causality is likely to flow from corporate governance to performance rather than the other way round[1]. Numerous studies also find that individual attributes of good governance are associated with higher performance (Nguyen and Aman 2006; Brown and Ngo Higgins 2001; Xu and Wang 1999; Core et al. 1999; Diacon and O'Sullivan 1995; Kang and Shivdasani 1995; Mak and Li 2001; Dahya et al. 1998; Firth et al. 2006).

There is an ongoing debate on whether the Western governance mechanisms are applicable to developing economies which might need different corporate governance systems (Perotti and Gelfer 2001; Black 2001; Buck et al. 2000; Filatotchev et al. 1999; Dynkin and Ivanova 1998; Frydman et al. 1996; Puffer and McCarthy 2003; Buck 2003; Peng et al. 2003; Preobragenskaya and Mcgee ; Black et al. 2006; Judge et al. 2003). With the new and emerging market economies seeking to implement the "right" corporate governance, this debate has attracted serious attention from finance and legal scholars (John and Senbet 1998; Chen et al. 1999; Buck et al. 2000; Yoshikawa and Phan 2003; Buck 2003; Suk-Yee Lee et al. 2005).

Whether the Western governance findings related to developing economies requires further empirical research. This research seeks to add to this literature but restricts its focus to four key governance variables:

- Shareholder Structure
- Board Independence
- Audit Quality
- Accounting Standards

No one study can cover all governance attributes however the four variables chosen in this study are the governance attributes that differ between the A and B share markets. In addition, they are the variables that other studies have shown are significantly related to firm performance (Firth et al.

[1] There is a compelling argument for causality in the other direction. Poor performance by a firm may lead to changing their board structures and other governance variables (Dahya et al., 1998, Firth et al., 2006).

2006; Chung et al. 2002; Caballero and Krishnamurthy 2001; Zhou 2001; Benston 1982; Ding et al. 2007; Chen et al. 1999; Gao and Tse 2004; Firth et al. 2007).

SHAREHOLDER STRUCTURE

Since Berle and Means (1932), the relationship of ownership and control to firm performance is one of the most popular and enduring research topics in disciplines ranging from law and economics to management (LIU and WOO 2001; Kapopoulos and Lazaretou 2007; Bratton 2001; La Porta et al. 2000).

Berle and Means (1932) addressed the problem of management responsibility stemming from the separation of ownership and control and implied that diffuse ownership adversely affects firm performance (Bratton 2001; Kapopoulos and Lazaretou 2007). From the recent development in the theory of firm's ownership structure and its associated control mechanism, two dimensions have evolved:

- the concentration of shareholdings/the degree of control, and
- the identity or class of controlling shareholders.

There is a large body of empirical literature focusing on the concentration of shareholdings dimension (Xu and Wang 1999; Brunello et al. 2003; Tian and Estrin 2005; Wang 2005; Goergen and Renneboog 2001; Bushman et al. 2004; Ding et al. 2007). This literature tests whether 'owner controlled' or 'manager controlled' companies performed better (Core and Larcker 2002; Zhou 2001; Coles et al. 2001; Himmelberg et al. 1999; Hirschey 1999; Xu and Wang 1999; Craswell et al. 1997; Lichtenberg and Pushner 1994; Rosenstein and Wyatt 1990; Boubakri et al. 2004; Yoshikawa and Phan 2003; Qiang 2003; Tian and Estrin 2005; Ho and Shun Wong 2001; Brown and Ngo Higgins 2001; Bauer et al. 2003; Lemmon and Lins 2001; Denis 2001; Walker 2006; Wang 2005; LIU and WOO 2001). General speaking, dominant external shareholders would concern themselves only with the firm's performance whereas internal shareholders may have other interests and objectives (Short 1994; LIU and WOO 2001; Nickell et al. 1997; McConnel and Servaes 1990; Morck et al. 1988).

CHINESE SHAREHOLDER STRUCTURE

The unique ownership structure of Chinese listed companies provides an excellent laboratory to test the impact of ownership by type of shareholder on firm performance. Economists Shleifer and Vishny (1998) generally view government ownership as being detrimental to corporate performance. Estrin and Perotin (1991) argue that firm's performance can't be maximised under the control of the government shareholder because the state has political as well as economic objectives. Megginson and Netter (2001) point out that State ownership is widely believed

inefficient, and privatization results in improved performance. Tian and Estrin (2005) examine the ownership structure of 826 Chinese listed companies and find that government shareholding is surprisingly large and its effect on corporate value is found to be negative.

In line with the Western literature, the overall impact of state shareholding on corporate values in China is found to be negative. However, Qian (2003) suggest that in China government ownership can in fact be helpful, to company performance. The positive roles that the government shareholder can play come from preferential commercial treatment as well as governance advantages when state ownership is concentrated. Sun and Tong (2003) and Wang (2005) find that the relation between state ownership and operating performance is usually insignificant.

The presence of foreign shareholders of B-shares provide an interesting study of the impact of shareholder structure on firm performance between A-shares firms and AB-shares firms in China.

Combining the theory of inefficient government ownership with the Chinese institutional environment leads us to hypothesize that firms with a higher proportion of private shareholder, especially foreign shareholders will perform better than those that are heavily concentrated and dominated by the government shareholder.

The arguments for ownership structure in the Chinese market are:

- Government ownership may reduce firm performance due to the grabbing had of the government.
- Government ownership is consistent among sample firms and should not have a comparative impact on firm performance
- The existence of legal entities, while not being able to trade on markets, should lead to more improved firm performance particularly with respect to debt levels and debt governance
- The addition of B class shares and its concomitant western governance standards, when combined with the above should lead to stronger governance overall.

This leads to the first proposition as follows:

Proposition One:

Due to a higher proportion of private shareholder, especially foreign shareholders, AB- shares firms will perform better than A-shares firms that are heavily concentrated and dominated by the government shareholder.

THEORY OF BOARD INDEPENDENCE AND PERFORMANCE

The first defensive line of shareholders against management's opportunistic behavior is the board of directors (Weisbach 1993; Sundaramurthy et al. 1996; Watts and Zimmerman 1981; Watts and Zimmerman 1990; Bhagat and Black 1999; Hossain et al. 2001). The board of directors carries out the monitoring function on behalf of shareholders. It ensures that executive managers carry out their duties in a way that serves the best interests of shareholders. Without the board, shareholders would find it difficult to exercise control due to wide dispersion of ownership of common stock (Fama and Jensen 1983; John and Senbet 1998).

Much of the empirical research in corporate governance utilises data on formal board structures and independence to study the effectiveness of the board and its impact on firm performance (Tricker 1994; Warther 1994; Hirshleifer and Thakor 1994; John and Senbet 1998). These studies suggest that the effectiveness of the board is closely associated to the degree of board independence, and the board independence is highly related to its composition.

The role of the board and its independence may be compromised in the Chinese market for A-shares. Most board members and managers of China's listed firms have a status that corresponds to that of the civil servant. As ownership is heavily concentrated and dominated by the government, the board directors of China's listed firms, particularly A-shares firms, may not be concerned about the interest and rights of individual shareholders.

Highly independent boards impact on shareholders' perception of earnings reliability and relevance. This is because stronger board monitoring should enhance the information content of the financial reporting and should provide assurance to shareholders on the reliability of reported earnings (Anderson et al. 2003).[2] However, in the Chinese markets, the different status of Board Members, and their possibly compromised independence levels, may lead to a diminished impact of board independence and structure on firm performance.

If firms with both A and B shares have corporate cultures and practices that are similar to western firms, then their board structure should reflect a higher level of board independence. The greater independence of the boards of AB shares' firms should result in shareholders' perceiving earnings as being more reliable. This leads to the second proposition as follows:

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2 Not many studies empirically examining the impact of board independence on shareholders' perception of accounting earnings. Anderson et al., (2003) examine the impact and find that board independence is positively related to the information content of earnings. The results of Anderson et al. (2003) are limited by testing a single financial period and using a single proxy for unexpected earnings when testing the returns-earnings regression.

Proposition Two:

The independence of boards of AB-shares' firms produce more reliable earnings resulting in a significantly greater market reaction to earnings announcements relative to returns resulting from earnings announcements of A-shares firms.

AUDIT QUALITY

Auditors play a key role in terms of value relevance of accounting earnings as they provide investors with independent assurance that the firm's financial statements are fairly presented (Healy and Palepu 2001; Ball et al. 2000). Research shows that capital providers require firms to hire an independent auditor as a condition of financing, even when it is not required by regulation (Leftwich 1980). This implies that capital providers regard auditors as enhancing credibility (Klein 2002; Abdel-khalik 2002; Wild 1994; DeFond et al. 2004; Siew Hong and Wong 1993).

There is no empirical research that examines directly whether or not auditors significantly enhance the credibility of reported financial statements (Siew Hong 1992; Caballero and Krishnamurthy 2001; Brown and Ngo Higgins 2001; Khurana and Raman 2006; Hutchinson and Gul 2004). Healy and Palepu (2001) show the audit –related factors that affect credibility of financial statements include differences in audit standards, the legal framework governing the audit profession, enforcement of standards and rules, and differences in professional training requirements. However research identifies auditor independence as the significant determinant of audit quality to financial statement credibility.

A key element of audit quality is related auditor size and consequently suggests a positive association between audit quality and auditor size. Numerous studies in many countries have found that the largest audit firms with international reputations earn fee premiums due to their perceived higher quality (Niemi 2004). These fees reflect that high quality of audits impact on the reliability of the reports of company.

Empirical research using Korean data, show there is no difference in audit fees between Big Six and non-Big Six, but Big Six auditors spend more time on their audits. The finding of Choi and Paek (2000) has implications for developing markets. While the quality difference between Big Six and other auditors is not recognised in fees, a large number of audit undertaken by the large firms many still provide the "net fee" difference suggested by DeAngelo (1981). The Chinese market reflects these characteristics. This suggests that Big Six auditors are not recognized as providing a higher quality service than non-Big auditors in at least one developing economy (Chung et al. 2002).

(DeFond et al. 2004) find that the presence of foreign shareholders provides an incentive for the international joint venture partners to act independently in order to protect their reputation in

international capital markets and suggest that Big Four auditors have a market advantage over local Chinese auditors among the clientele that demand high-quality audits. As the annual reports of AB-shares are required to be audited by International CPAs, the market should perceive their earnings announcements to be more reliable. Furthermore, the greater Auditor independence of AB-shares' firms should also result in shareholders' perceiving earnings as being more reliable.

If firms with both A and B shares have audit practices that are similar to western firms, then their financial statements should reflect a higher level of Auditor quality. This leads to the third proposition as follows:

Proposition Three:

B-shares' financial statements audited by international CPAs have higher credibility and value-relevance than does A-shares firms' financial statements audited by Chinese CPAs.

MARKET SEGMENTATION

AB and A shares markets were rigidly segmented until February 2001. While domestic investors were allowed to invest in A-shares, foreign investors could invest only in B-shares. Domestic investors have been allowed to trade B-share using their foreign currency saving since 19 February 2001. This was attributed to the poorly performing A-shares, illiquid B-shares' markets and the government's aiming to finance its social security fund gap. Furthermore, Qualified Foreign Institutional Investors (QFII) granted foreign institutions access to the domestic A share market on 1 December 2002 (Qiang 2003; Ji 2005; Zhang and Wu).

Despite these reforms, the question still remains, are the A-shares and B-shares markets no longer segmented after 2001? Because domestic investors have to use foreign currency to trade B shares, it may be argued that the Chinese stock markets are still partial segmented, particularly given China's strict foreign currency control. This argument is consistent with the finding of Mei et al.(1999), as they indicate that the relaxation of restrictions on purchase of B-shares by domestic investors did not eliminate all premiums and they remained at a level around 80%.

Chen et al.(2006) argue that a certain degree of segmentation still exists today and it is impossible for investors to take advantage of arbitrage opportunities. This is because China's local currency, the Renminbi, is still not freely convertible - Chinese investors cannot purchase foreign currency in order to B-shares, and short selling is not allowed in either the A or B share markets.

Given the restrictions on foreign currency purchases, the Chinese A-shares investor faces similar restrictions when considering arbitrage opportunities in the B-shares market and the B-shares market investor has similar characteristics to the investor on the foreign listing market. Based on the limited literature on cross listing of firms (Chakravarty et al. 1998; Hooper and Heaney 2000; Ji

2005; Hietala 1989) and for markets where shares owned by foreign investors are trades separate from domestically-owned shares, we suggest that the segmented markets will effect market performance. Studies suggest that cross listing and or providing a segmented foreign market on a domestic board results in premiums over and above the domestically traded shares (Stulz and Wasserfallen (1995); Bailey et al. (1999); Hietala (1989); Baily and Jagtiani (1994); Domowitz et al. (1997))

However, the Chinese market shows the opposite behaviour. The existing arguments and factors that explain the price premium in other markets cannot explain the opposite phenomenon in China. B-shares are known to trades at substantial discount to domestic A-shares. This anomaly has generated much interest among researchers (Suk-Yee Lee et al. 2005; Ji 2005; Guercio and Hawkins 1999; Bailey et al. 1997; Bailey 1994; Bass and Steidlmeier 1999; Guo et al. 2001).

Qiang (2003), Bai et al.(2004) and Ji (2005) suggest that ineffective governance system has been believed as the root cause of the B-shares discounts. Their findings can be interpreted conversely that good corporate governance attracts a premium. McKinsey's findings on emerging markets show 80% of institutional investors and private equities are willing to pay a premium to well-governed firms. If this argument holds, then Chinese investors must view western governance standards as "poor" standards when compared to the Chinese standards.

If the governance arguments hold, and the A-shares market views earnings announcements as more reliable than does the B-shares market, then the response to an earnings announcement will be greater in the A-shares market than in the B-shares market. The above discussion regarding the segmenting of markets leads to the fourth proposition as follows:

Proposition Four:

(a) *If Chinese stock markets are segmented, there is no difference in terms of reliability between an A-share company and an A-share of AB-shares company. However B-share should have a lower response than A-share in an AB-shares company.*

Post 2001, the market segmentation should cease to exist.

(b) *If Chinese stock markets are not segmented, markets response to an A-share company's announcement will be less than the response to an equivalent announcement of an A-share of AB-shares company. For a B-share announcement, there should be no difference in the response to the A-share and B-share of an AB shares company.*

RESEARCH METHOD

An event study methodology tests the four propositions developed from the literature using the abnormal returns (CAR- Cumulative Average Residuals) to measure the impact of governance on the performance of shares. Because there exists a class of traded shares with key Western governance standards (the companies with both A-shares and B-shares), their CAR can be compared with a matched portfolio of companies with Chinese governance standards (companies with A-shares only).

Table 1 presents each proposition, a description of the experimental design, and the tests that support or reject the null hypotheses. The strength of the Chinese market as a site for testing the effects of governance comes with complications. These complications are:

a. The apparent segmentation of the Chinese market prior to 2001 whereby Chinese local investors could not purchase B-shares. This research tests the aggregate period 1999 to 2003 and two portions of 1999 to 2000, 2001 to 2003.

b. The pricing anomaly identified by Mei et al.(1999) whereby B-shares trade at a significant discount to A-shares. The sample period of Mei et al.(1999) was 1993-2001. Using an event study allows control for the factors.

Proposition One to Three use Hypothesis One to test the market response to earnings for the period of 1999 to 2003. Because of possible segmentation issues, Hypothesis One is testing for the periods post and pre2001, and for the individual years. Hypothesis Two tests the relevance of international accounting standards. AB-shares companies produce two financial reports, one based on IAS and one based on Chinese GAPP.

Hypothesis Three and Four test the market segmentation theory.

Table 1: Summary of the experimental designs of the propositions

Proposition	***Description***	***Experimental Design***	***Hypothesis - Test of Significance***
One	*Due to a greater independence of the boards of AB-shares' firms, the earnings of AB shares should be more reliable. Therefore, the market reaction to earnings announcements by AB-shares firms will result in significantly greater positive returns relative to returns resulting from earnings announcements of A-shares firms.*	*Event study of abnormal returns of A and AB.*	*Hypothesis One-* H_o $\text{CAR}_{\text{A of AB}} \leq \text{CAR}_{\text{A}}$
Two	*Due to a higher proportion of private shareholder, especially foreign shareholders, AB-shares firms will perform better than A-shares firms that are heavily concentrated and dominated by the government shareholder.*	*Event study of abnormal returns of A and AB.*	
Three	*B-shares' financial statements audited by international CPAs have higher credibility and value-relevance than A-shares firms' financial statements audited by Chinese CPAs, because of this superior reliability.*	*Event study of abnormal returns of A of AB and A*	

Four(a)	*If Chinese stock markets are segmented prior to 2001, there is no difference in terms of reliability between an A-share company and an A-share of AB-shares company. However B-share should have a greater response than A-share in an AB-shares company, because of the superior reliability.*	*Event study of abnormal returns of A of AB and B of AB.*	*Hypothesis Three-* H_o $\text{CAR}_{\text{B of AB}} \leq \text{CAR}_{\text{A of AB}}$
Four(b)	*If Chinese stock markets are not segmented, markets response to an A-share company's announcement will be less than the response to an equivalent announcement of an A-share of AB-shares company. For a B-share announcement, there should be no difference in the response to the A-share and B-share of an AB-shares company.*	*Event study of abnormal returns of A, A of AB and B of AB.*	*Hypothesis Four-* H_o $\text{CAR}_{\text{A of AB}} \neq \text{CAR}_{\text{B of AB}}$

SAMPLE AND DATA COLLECTION PROCEDURES

The study covers the reporting period from 1st of January 1999 to 31st December 2003. At the end of December 2003, number of listed companies in SHSE is 824 (770 A-shares, 54 B-shares, including 10 pure B-share companies) and in SZSE is 548 (491 A-shares, 57 B-shares, including 14 pure B-share companies).

MATCHING CRITERIA

The sample covered companies from manufacturing, commercial, telecommunication, banking, transportation, public utilities, and other industrial sectors. The securities were selected from the population of all AB-share securities of SHSE and SZSE, for which daily return data were available. In addition two A-share securities were also selected. Thirteen firms issuing only B-shares or with incomplete data were excluded. The two A-shares were selected to provide a control comparison between A and B shares. The control sample was matched on Industry, Total assets, and Number of shares. While matching on the total shares is not a normal practice, we found it useful in limiting the potential heteroscedasticity problems in the data-analysis phase. Table 2 reconciles the sample selection with the total AB-companies trading during the test period.

TABLE 2: SUMMARY OF SELECTED SAMPLE FIRMS

Year	**1999**	**2000**	**2001**	**2002**	**2003**	**TOTAL**
SHSE						
B-share of AB-shares	41	42	44	44	44	
Less new listings past cut off	7	6	7	6	7	
B-share sample	**34**	**36**	**37**	**38**	**37**	
A-share of AB-shares (less new listings)	**34**	**36**	**37**	**38**	**37**	
A-share only	430	517	592	661	726	
Less firms not in industry	269	356	379	407	474	
Less firms with assets outside range	58	62	86	91	119	
Less firms with shares outside range	35	27	53	87	59	
A-share paired sample	**68**	**72**	**74**	**76**	**74**	
Total Sample	***136***	***144***	***148***	***152***	***148***	

SZSE						
B-share of AB-shares	41	44	44	43	43	
Less new listings past cut off	7	10	7	6	5	
B-share sample	**34**	**34**	**37**	**37**	**38**	
A-share of AB-shares (less new listings)	**34**	**34**	**37**	**37**	**38**	
A-share only	411	457	456	452	450	
Less firms not in industry	283	304	306	305	300	
Less firms with assets outside range	36	48	42	43	42	
Less firms with shares outside range	24	37	34	30	32	
A-share paired sample	**68**	**68**	**74**	**74**	**76**	
Total Sample	***136***	***136***	***148***	***148***	***152***	
SHSE & **SZSE** Total Sample	272	280	296	300	300	1448

Daily stock price, volume data and market indices were provided by the two stock exchanges and reconciled with the China Stock Market and Accounting Research (CSMAR) database[3]. Accounting, dates of announcements and other related company data were collected from the annual reports, the financial newspapers, the yearbooks of the two exchanges, and the CSMAR database.

EVENT STUDY

This application of the event study's methodology is motivated by developments in both research and practice on the valuation effects of accounting information releases. Numerous studies find evidence of the informational content of earnings announcements among U.S markets and a number of non-U.S. markets (Cable and Holland 1999; Brown and Ngo Higgins 2001; Aktas et al. 2007; Ball et al. 2000; Corrado and Zivney 1992; Campbell and Wesley 1993; Ball and Brown 1968; Ball and Kothari 1991; Atiase and Bamber 1994; Klein 2002).

In addition, an event study methodology helps control for some idiosyncratic aspects of the Chinese Markets. Specifically, A-shares in an AB-share company trade at prices significantly higher than those of their B share counterpart (Chen et al. 2001; Li et al. 2006; Bass and Steidlmeier 1999). While in the pre-2001 market this may have been caused by a lack of liquidity in the B-share market, the abnormality still exists post 2001 when Chinese nationals with foreign currency could

[3] CSMAR database were jointly developed by the China Accounting and Finance Research Centre of Hong Kong Polytechnic University and the Shenzhen GTA Information Technology Co. Ltd.

purchase B-shares. Arbitrage opportunities for Chinese traders should results in the difference being traded away. Some research suggest that this anomaly is a function of political risk (Zhang and Zhao 2004; Hooper and Heaney 2000; Bass and Steidlmeier 1999; Chen et al. 2006). This explanation is less than satisfactory if one assumes that at a minimum, there is a weak-form-efficient market. Prior to 2001, foreign investors could have diversified away political risk. Post 2001 the same argument applies to foreign investors and Chinese domestic investors would perceive the political risks as the same between AB-shares in the same company.

Another explanation is that the difference is the result of the undervaluing of the RMB exchange rate. This proposition is yet to be fully tested. As a result of the difference in the values between AB-shares, any test of the Ohlson (1995) or Easton and Harris (1991) that do not control for the "unknown" variable may mask the effect of corporate governance variables. The event study enables one to identify the unique impact of an earnings announcement after controlling for the effect of other valuables.

To test whether the Chinese markets react differently due to the the relaxation of restrictions on purchase of B-shares by domestic investors in 2001, the sample is divided into two testing period, pre 2001 and post2001.

Further, to differentiate the markets' reaction to different information, the sample for each sub-period is classified into two groups based on the outcome of the event. An announcement belongs to Group I if the outcome of the event is ''good news'' (actual EPS exceeds last EPS). It belongs to Group II if the outcome of the event is ''bad news'' (actual EPS is equal to or less than last EPS) (Su 2003; Gao and Tse 2004).

In theory, good news announcement or bad news announcement should be based on firm's performance relative to the market's expected performance. Traditionally analyst's forecasts are the surrogate used for expected-market performance. However, earnings forecast reports were not available for the test period (Gao and Tse 2004; Su 2003; Eng and Mak 2003; Zhou 2001). For this research, the prior-quarter profit result was used as the surrogate fore market expectations. Where a firm outperformed its prior quarter earnings per share, it was classified as "good news". An EPS is lower than prior quarter classified the firm as "bad news".

ABNORMAL RETURN

Three different return-generating models (RGM), Market Model, Market-Adjusted Returns Model and Mean-Adjusted Returns Model were used to examine the abnormal stock returns (Brown and Ngo Higgins 2001). The earnings announcement day is selected as the predictable event day for

accessing the abnormal stock returns. If the market is efficient, stock prices should reflect all potential changes in the event outcomes (Su 2003).

The event date is designated t = 0 as, the announcement date, the day of the annual earnings for a given security. For each security we use a maximum of 250 daily return observations for the period around its respective event, starting at day - 239 and ending at day + 10 relative to the event. The first 219 days in this period (- 239 through - 21) is designated the 'estimation period', and the following 31 days (- 20 through + 10) is designated the 'event period'.

In the event study literature, the null hypothesis to be tested is whether the mean abnormal return (the average residual, AR) at time t is equal to zero. The focus on the mean of the distribution of abnormal returns is to understand whether the event is, on average, associated with a change in security holder wealth (Ball et al. 2000; Ball and Kothari 1991; Brown and Ngo Higgins 2001).

In this study, abnormal returns are tested for statistical significance using both parametric and non-parametric tests. The performance of a portfolio method statistic, T_1, is compared with two alternative tests: Cross-sectional independence, T_2, and Corrado and Ziverny (1992) Sign test, T_3.

For tests over the (- 20, + 10) interval, the test statistic is the ratio of the cumulative mean abnormal returns (CARs) to the estimated standard deviation, and is given where the terms in the denominator are from equation [3-6]. CARs method tests the null hypothesis that abnormal performance is equal to zero. The null hypothesis is rejected if the test statistic exceeds a critical value, typically corresponding to the 5% region (Fama et al. 1969; Brown and Ngo Higgins 2001).

ANALYSIS AND RESULTS

Descriptive statistics were generated for the samples used for each of the hypotheses to be tested. Stock price, PE ratio, earnings per share, total asset, total liabilities and number of share issued were collected and analysed.

B-share prices increased significantly in both Shanghai and Shenzhen markets in 2000. This phenomenon could be the expectation of the relaxation of restrictions on purchase of B shares by domestic investors effective from February 2001. However the regulation changed in 2001 did not eliminate the A-shares price premiums. But it reduced from a level around 80% to 50% in both Shanghai and Shenzhen markets. A-shares price premiums have remained at a level around 50% for both Shanghai and Shenzhen markets. This finding is consistent with the finding of Mei et al.(1999). The implication of this finding suggests that the Chinese markets may have remained segmented after the regulation change in 2001.

Table 3: Sample Descriptive Statistics 1999-2003

Period: 1999-2003 Type of Shares						
Shanghai A	**P**	**PE**	**EPS**	**TA**	**TL**	**No. of Share**
Mean	12.07	104.52	0.17	2,034,480	958,454	395,607
Standard Deviation	4.79	105.07	0.23	3,582,286	2,821,903	549,713
Minimum	3.38	7.72	-1.00	325,156	65,294	87,207
Maximum	32.17	552.56	0.72	31,699,991	25,217,413	4,866,950
N=364						
Shanghai A of AB	**P**	**PE**	**EPS**	**TA**	**TL**	**No. of Share**
Mean	12.51	256.87	0.05	3,277,962	1,896,855	540,995
Standard Deviation	3.11	284.39	0.23	3,053,843	2,490,596	332,888
Minimum	5.43	-31.25	-0.65	421,739	166,817	115,133
Maximum	20.37	1,270.40	0.50	16,965,638	14,958,381	1,867,684
N=182						
Shanghai B of AB	**P**	**PE**	**EPS**	**TA**	**TL**	**No. of Share**
Mean	5.44	93.44	0.05	3,277,962	1,896,855	540,995
Standard Deviation	1.48	93.99	0.23	3,053,843	2,490,596	332,888
Minimum	3.16	-20.46	-0.65	421,739	166,817	115,133
Maximum	9.95	290.87	0.50	16,965,638	14,958,381	1,867,684
N=70						
Shenzhen A	**P**	**PE**	**EPS**	**TA**	**TL**	**No. of Share**
Mean	10.48	66.01	0.13	1,907,762	763,463	418,329
Standard Deviation	3.83	111.82	0.26	1,391,648	718,467	295,120
Minimum	5.05	-648.00	-0.74	168,912	67,430	90,486
Maximum	20.47	392.26	0.74	6,732,571	4,459,011	1,627,500
N=360						
Shenzhen A of AB	**P**	**PE**	**EPS**	**TA**	**TL**	**No. of Share**
Mean	11.64	135.84	0.14	3,259,009	1,794,842	531,621
Standard Deviation	3.42	190.33	0.40	2,873,385	1,705,528	412,447
Minimum	6.22	-40.43	-1.09	250,026	85,950	163,416
Maximum	23.12	833.20	1.18	11,250,712	5,540,270	2,368,264
N=180						
Shenzhen B of AB	**P**	**PE**	**EPS**	**TA**	**TL**	**No. of Share**
Mean	5.64	60.29	0.14	3,259,009	1,794,842	531,621
Standard Deviation	2.18	75.10	0.40	2,873,385	1,705,528	412,447
Minimum	2.00	-12.89	-1.09	250,026	85,950	163,416
Maximum	13.13	360.43	1.18	11,250,712	5,540,270	2,368,264
N=180						

Notes:
P: Stock price (RMB) at the announcement date
EPS: Earnings per share (RMB) at the end of financial year
TA: Total Assets (RBM 000) at the end of financial year
TL: Total Liabilities (RMB 000) at the end of financial year
No. of Share: No. of Shares (000) issued at the end of financial year

A of AB shares also have a higher PE ratio than A-shares in both Shanghai and Shenzhen stock markets. For example, the PE ratio is an average of 165% greater in Shanghai and 97% greater in Shenzhen for the testing period from 1999 to 2003. This finding implies that Chinese listed companies based on Western governance perform better than Chinese listed companies based on Chinese governance. Furthermore, the expectation of the removal of the B-share trading restriction caused PE ratio to be boosted in both Shanghai and Shenzhen markets in 2000. However, PE ratio of the A of AB-shares remains greater than PE ratio of the B of AB-shares. This also suggests that the Chinese markets are still segmented after the B-share trading restriction lifted in 2001. The

descriptive statistics for the test period was presented in Table 3 for the total period only for both Shanghai and Shenzhen markets.

Hypothesis One

Hypothesis One tests for the impact of governance structure, board independence, share ownership, and audit quality for the periods of 1999-2000 and 2001-2003. It examines whether these structural factors have the same effect pre and post 2001. Tests were conducted using all three models. In general, the results for the Market model and the Market Adjusted Returns model are consistent. The Mean model is inconsistent with the other models when testing the effects of bad news.

The test of the hypothesis proceeds in two stages. First we determine whether the cumulative residuals (CRs) for the good news and bad news samples are significantly different from zero. Each sample contains a sub-sample of A-share and A of AB-share companies matched on the criteria specified earlier. In stage One, we test if the CRs for each sub-sample are significantly different from zero. Second we determine of the CRs are different between the sub-samples of matched pairs.

For stage One, the CRs for each sub-sample are tested to examine whether they are significantly different from zero. Table 4, Table 5, Table 6 and Table 7 present test statistic computed based on Market model, Mean model and Market Adjusted Returns model for the pre 2001 period. The results for the Shanghai market are shown in Table 4 and Table 6. Table 4 presents the result of good news announcements and Table 6 presents the results of bad news announcements. Table 5 and Table 7 show the corresponding results for the good news and bad news announcements for the Shenzhen market. From the results[4] of Table 4 and Table 5, the CRs of good news announcements are all significantly different from zero for the Shanghai and Shenzhen markets.

Table 4: Shanghai Good News Earnings Response - CR T-Statistic 1999-2000

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	3.12*	22.53*	3.11*
Mean Model	CAR T1	1.70*	10.62*	7.86*
Market Adjusted Returns	CAR T1	6.38*	25.08*	10.30*
	N:	43	43	109

* = Significant at P = 5%
Interval :CAR -10, +10
Rejection region at 5%
T1: the standard portfolio method t-statistic

[4] The results of T1 (the standard portfolio method) are consistent with the results of T2 (the cross-sectional) and T3 (the Carrando and Zivney sign test). Detailed calculations are presented in Appendix 5 to Appendix 26.

Table 5: Shenzhen Good News Earnings Response - CR T-Statistic 1999-2000

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	6.24*	20.93*	3.31*
Mean Model	CAR T1	5.35*	11.71*	5.77*
Market Adjusted Returns	CAR T1	8.40*	20.83*	8.08*
	N:	54	54	108
* = Significant at P = 5%				
Interval :CAR -10, +10				
Rejection region at 5%				
T1: the standard portfolio method t-statistic				

From the results of Table 6 and Table 7, it can be seen that the CRs of bad news announcements are almost significantly different from zero for the Shanghai and Shenzhen markets.

Table 6: Shanghai Bad News Earnings Response - CR T-Statistic 1999-2000

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	8.81*	12.32*	-5.17*
Mean Model	CAR T1	1.93*	0.83	-3.40*
Market Adjusted Returns	CAR T1	11.12*	12.60*	-5.15*
	N:	27	27	31
* = Significant at P = 5%				
Interval :CAR -10, +10				
Rejection region at 5%				
T1: the standard portfolio method t-statistic				

Table 7: Shenzhen bad News Earnings Response - CR T-Statistic 1999-2000

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	-1.04	3.76*	11.91*
Mean Model	CAR T1	-3.49*	-3.34*	7.27*
Market Adjusted Returns	CAR T1	-0.12	3.29*	8.67*
	N:	14	14	28
* = Significant at P = 5%				
Interval :CAR -10, +10				
Rejection region at 5%				
T1: the standard portfolio method t-statistic				

A better understanding of the statistical result s for the period 1999 to 2000 can be seen from the graphs of the CRs. Figure 2 and Figure 3 show event- period graphs of the CRs for "Good News" announcements for Shanghai and Shenzhen respectively. It can be seen clearly that the residuals of A of AB-shares is greater than A-shares' for the Shenzhen market only.

Figure 2: Shanghai Good News Earnings Responses 1999-2000

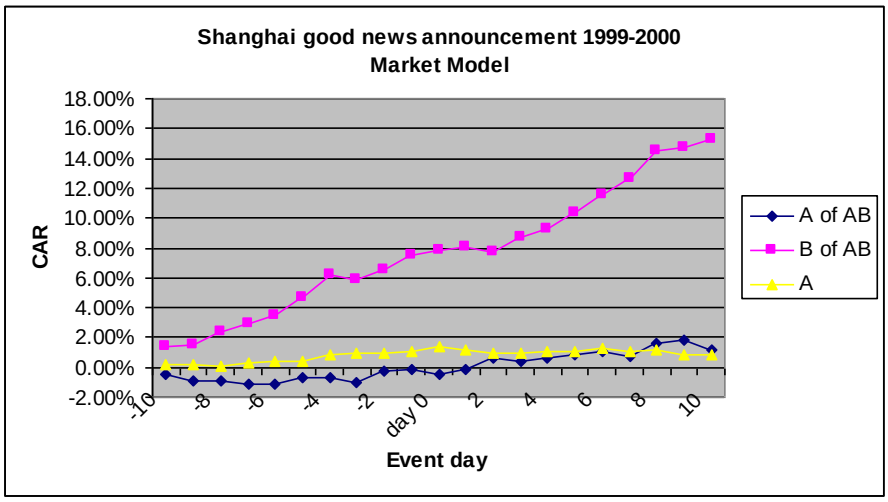
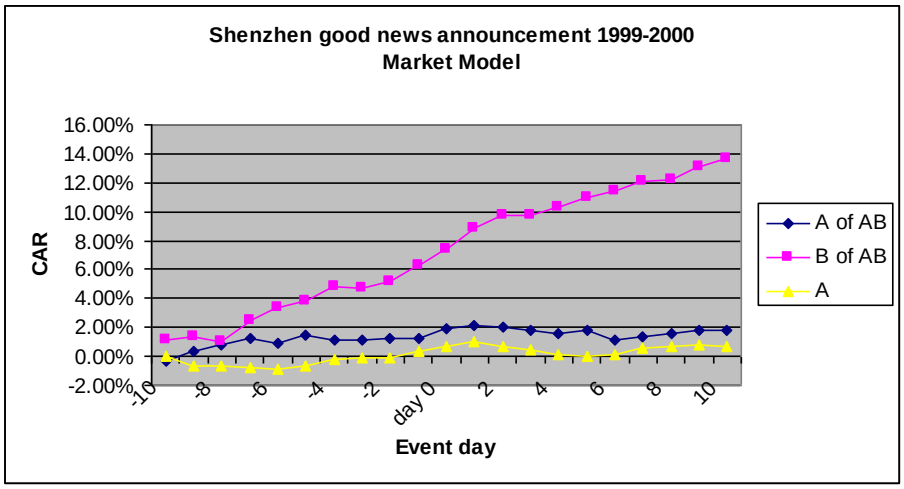


Figure 3: Shenzhen Good News Earnings Responses 1999-2000



For stage Two, we determine if the CRs are different between the sub-samples of matched pairs. The results are shown in Table 8 and Table 9. Table 8 shows that the mean of A of AB-share CARs is slightly greater than A-shares but it is not significant (p = 0.05). The results do not support H1A1 therefor it should be rejected.

Table 8: Matched Pairs t-Test For Shanghai Good News CR 1999-2000 (A of AB : A) - t-Test: Paired Two Sample for Means

	A of AB	A
Mean	0.012121	0.00997176
Variance	0.006884	0.00460199
Observations	43	43
Pearson Correlation	0.081245	
Hypothesized Mean Difference	0	
df	42	
t Stat	0.137089	
P(T<=t) one-tail	0.445808	
t Critical one-tail	1.681952	
P(T<=t) two-tail	0.891615	
t Critical two-tail	2.018082	

Table 9: Matched Pairs t-Test - Shenzhen Good News Announcements CR 1999-2000 (A of AB : A) -t-Test: Paired Two Sample for Means

	A of AB	A
Mean	0.01797723	-0.01967278
Variance	0.015062829	0.006741109
Observations	54	54
Pearson Correlation	0.177210759	
Hypothesized Mean Difference	0	
df	53	
t Stat	2.048983351	
P(T<=t) one-tail	0.022714425	
t Critical one-tail	1.674116237	
P(T<=t) two-tail	0.045428849	
t Critical two-tail	2.005745949	

From the results of Table 9, it can be seen that the mean of A of AB-share CARs is greater than A-shares' and t-statistic is 2.04, which is significant at P=0.02. The results support that the earnings response of the A of AB-shares is greater than A-shares' for the Shenzhen market and therefore H1B1 should not be rejected. In terms of "Bad News" announcements, the statistical results for the period 1999 to 2000 can be seen from the graphs of the CRs

For the results of matched pairs, they are shown in Table 10 and Table 11. Table 10 shows that the mean of A of AB-share CARs is greater than A-shares' and t-statistic is 2.73, which is significant at P of 0.005. The results support that the earnings response of the A of AB-shares for the "Bad News" announcements is greater than A-shares' for the Shanghai market and therefore H1C0 should be rejected.

Table 10: Matched Pairs t-Test For Shanghai Bad News Announcements CRs 1999-2000 (A of AB : to A) - t-Test: Paired Two Sample for Means

	A of AB	A
Mean	0.043913	-0.02326502
Variance	0.009348	0.008401725
Observations	27	27
Pearson Correlation	0.079184	
Hypothesized Mean Difference	0	
df	26	
t Stat	2.730286	
P(T<=t) one-tail	0.005604	
t Critical one-tail	1.705618	
P(T<=t) two-tail	0.011207	
t Critical two-tail	2.055529	

From the results of Table 11, it can be seen that the mean of A of AB-share CARs is less than A-shares' and t-statistic is -1.29, which is not significant at 0.05 level of significance. The results do

not support that the earnings response of the A of AB-shares for the "Bad News" announcements is greater than A-shares' for the Shenzhen market and therefore H1D1 should be rejected.

Table 11: Matched Pairs t-Test For Shenzhen Bad News Announcements 1999-2000 CR (A of AB : to A) - t-Test: Paired Two Sample for Means

	A of AB	A
Mean	-0.0029668	0.0541040
Variance	0.0201496	0.0161284
Observations	14	14
Pearson Correlation	0.254226675	
Hypothesized Mean Difference	0	
df	13	
	-	
t Stat	1.296871702	
P(T<=t) one-tail	0.108610755	
t Critical one-tail	1.770933383	
P(T<=t) two-tail	0.21722151	
t Critical two-tail	2.160368652	

For pre 2001, mixed results were found for the test of Hypothesis One (a) when controlling for good news and bad news and for the market in which the shares are traded. For the Shanghai Market, there is no significant difference between the CARs of the A of AB shares compared with those of the A shares while there is a significant difference for the "bad news" portfolio. Conversely, the Shenzhen market shows a significant differences between the CARs of the A of AB shares compared with those of the A shares for "good news" announcements but no significant difference for "bad news" announcements. The results of Hypotheses One (a) for the pre 2001 period are inconclusive.

Table12: Shanghai Good News Earnings Response - CR T-Statistic 2001-2003

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	-4.92*	-7.36*	-3.83*
Mean Model	CAR T1	0.52	-6.16*	14.71*
Market Adjusted Returns	CAR T1	-4.98*	-6.92*	-3.35*
	N:	69	69	169
* = Significant at P = 5%				
Interval :CAR -10, +10				
Rejection region at 5%				
T1: the standard portfolio method t-statistic				

Table13: Shenzhen Good News Earnings Response - CR T-Statistic 2001-2003

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	-2.84*	-2.98*	0.04
Mean Model	CAR T1	-3.15*	-3.28*	3.93*
Market Adjusted Returns	CAR T1	-2.77*	-1.18	3.04*
	N:	77	77	148
* = Significant at P = 5%				

Interval :CAR -10, +10
Rejection region at 5%
T1: the standard portfolio method t-statistic

For the results of the post 2001 period, Table 12, Table 13, Table 14 and Table 15 present test statistic computed based on Market model, Mean model and Market Adjusted Returns model for the pre 2001 period. The results for the Shanghai market are shown in Table 12 and Table14. Table 12 presents the result of good news announcements and Table 14 presents the results of bad news announcements. Table 13 and Table 15 show the corresponding results for the good news and bad news announcements for the Shenzhen market. From the results of Table 12 and Table 13, it can be seen that the CRs of good news announcements are almost significantly different from zero for the Shanghai and Shenzhen markets.

From the results of Table 14 and Table 15, it can be seen that the CRs of bad news announcements are significantly different from zero for the Shanghai and Shenzhen markets.

Table 14: Shanghai Bad News Earnings Response - CRs T-Statistic 2001-2003

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	-15.75*	-19.92*	-2.68*
Mean Model	CAR T1	-12.59*	-18.78*	-1.07
Market Adjusted Returns	CAR T1	-11.91*	-16.65*	-5.48*
	N:	43	43	55

* = Significant at P = 5%
Interval :CAR -10, +10
Rejection region at 5%
T1: the standard portfolio method t-statistic

Table15: Shenzhen bad News Earnings Response - CRs T-Statistic 2001-2003

Model	Class of Shares	A of AB	B of AB	A
	T-Statistic			
Market Model	CAR T1	-9.87*	-12.22*	-6.17*
Mean Model	CAR T1	-11.14*	-14.55*	-6.08*
Market Adjusted Returns	CAR T1	-15.28*	-15.72*	-12.51*
	N:	35	35	76

* = Significant at P = 5%
Interval :CAR -10, +10
Rejection region at 5%
T1: the standard portfolio method t-statistic

For the results of matched pairs, they are shown in Table 15 and Table 16. Table 17 shows that the mean of A of AB-share CARs is less than A-shares' and t-statistic is -0.86, which is not significant at 0.05 level of significance. The results do not support that the earnings response of the A of AB-shares for the "Good News" announcements is greater than A-shares' for the Shanghai market and therefore H1E1 should be rejected.

Table 15: Matched Pairs t-Test For Shanghai Good News Announcements CRs 2001-2003 (A of AB : to A) - t-Test: Paired Two Sample for Means

	A of AB	A
Mean	-0.01041	0.00587451
Variance	0.005863	0.01843586
Observations	69	69
Pearson Correlation	0.005085	
Hypothesized Mean Difference	0	
df	68	
t Stat	-0.86979	
P(T<=t) one-tail	0.193737	
t Critical one-tail	1.667572	
P(T<=t) two-tail	0.387475	
t Critical two-tail	1.995469	

From the results of Table 15, it can be seen that the mean of A of AB-share CARs is less than A-shares' and t-statistic is -1.02, which is not significant at 0.05 level of significance. The results do not support that the earnings response of the A of AB-shares for the "Good News" announcements is greater than A-shares' for the Shenzhen market and therefore H1F1 should be rejected.

Table 16: Matched Pairs t-Test For Shenzhen Good News Announcements CRs 2001-2003 (A of AB : A) t-Test: Paired Two Sample for Means

	A of AB	A
Mean	-0.005325	0.005250783
Variance	0.006032	0.012623896
Observations	77	77
Pearson Correlation	0.268608	
Hypothesized Mean Difference	0	
df	76	
t Stat	-0.785195	
P(T<=t) one-tail	0.21739	
t Critical one-tail	1.665151	
P(T<=t) two-tail	0.43478	
t Critical two-tail	1.991673	

In terms of "Bad News" announcements, the statistical results for the period 2001 to 2003 can be seen from the graphs of the CRs.

For the results of matched pairs, they are shown in Table 16 and Table 17. From the results of Table 16, it can be seen that there is a significant difference between the means, P=0.008. However, the mean of A of AB-share CARs is less than A-shares'. The results do not support that the earnings response of the A of AB-shares for the "Bad News" announcements is greater than A-shares' for the Shanghai market and therefore H1G1 should be rejected.

Table 16: Matched Pairs t-Test For Shanghai Bad News Announcements CRs 2001-2003 (A of AB : to A) t-Test: Paired Two Sample for Means

	A of AB	A
Mean	-0.04971	-0.00847575
Variance	0.009763	0.006286473
Observations	43	43
Pearson Correlation	0.27497	
Hypothesized Mean Difference	0	
df	42	
t Stat	-2.49545	
P(T<=t) one-tail	0.008297	
t Critical one-tail	1.681952	
P(T<=t) two-tail	0.016594	
t Critical two-tail	2.018082	

Table 17 indicates that the mean of A of AB-share CARs is less than A-shares' and t-statistic is -0.98, which is not significant at 0.05 level of significance. The results do not support that the earnings response of the A of AB-shares for the "Bad News" announcements is greater than A-shares' for the Shenzhen market and therefore H1H1 should be rejected.

Table 17: Matched Pairs t-Test For Shenzhen Bad News Announcements CRs 2001-2003 (A of AB : to A) t-Test: Paired Two Sample for Means

	A of AB	A
Mean	-0.028076	-0.00274799
Variance	0.012165	0.008408843
Observations	35	35
Pearson Correlation	-0.134126	
Hypothesized Mean Difference	0	
df	34	
t Stat	-0.981936	
P(T<=t) one-tail	0.166534	
t Critical one-tail	1.690924	
P(T<=t) two-tail	0.333067	
t Critical two-tail	2.032244	

For the post 2001 period, the CARs for the A of AB shares are not significantly greater than those of the A-shares for Shanghai and Shenzhen markets. The effect of these structural factors for the pre 2001 period is greater than the effect for the post 2001. However, these effects are not significant. The results of Hypotheses One (b) do not support that a better governance structure of A of AB shares will result in significantly greater abnormal returns.

TEST RESULTS FOR HYPOTHESIS TWO

The earnings of the B-shares based on IAS, in contrast to Chinese GAAP, are more value-relevant due to increased information disclosures. Hypothesis Two tests the relevance of international accounting standards. It examines whether investors react differently to earning announcements based on IAS and earnings announcements based on Chinese GAAP for the period of 2001-2003.

The basis of this test rests with the nature of the disclosures. Financial statements are presented in a fashion similar to that of dual companies accounts prepared under international accounting standards are reconciled to the results using Chinese accounting standards. When the announcement of an AB-shares company occurs, the newspapers carry the Chinese profit number. If the A and B of the AB-shares operate in a segmented market, we would expect significant differences in the CARs.

As shown in the descriptive statistics, B-shares' experienced a significant growth in share price for the pre 2001 period. This phenomenon could be the expectation of the relaxation of restrictions on purchase of B-shares in 2001. B-shares' significant growth for the pre 2001 period may provide an invalid testing result. Therefore, the test period of Hypothesis Two is the post 2001.

The results of the stage One for the post 2001 period are also presented in Table 5-14, Table 5-15, Table 5-16 and Table 5-17. From the results of these tables, it can be seen that the CRs of good news and bad news announcements are significantly different from zero for the Shanghai and Shenzhen markets.

The results of matched pairs for Hypothesis Two are shown in Table 18, Table 19, Table 20 and Table 21. The results for the Shanghai market are shown in Table 18 and Table 20. Table 18 presents the result of good news announcements and Table 20 presents the results of bad news announcements. Table 19 and Table 21 show the corresponding results for the good news and bad news announcements for the Shenzhen market.

From the results of Table 18, it can be seen that the mean of A of AB-share CARs is slightly greater than B of AB-shares' and t-statistic is 0.85, which is not significant at 0.05 level of significance. The results do not support that the earnings response of the B of AB-shares for the "Good News" announcements is greater than A of AB-shares' for the Shanghai market and therefore $H2A_1$ should be rejected.

Table 18: Matched Pairs t-Test For Shanghai Good News Announcements CRs 2001-2003 (A of AB : B of AB) t-Test: Paired Two Sample for Means

	A of AB	B of AB
Mean	-0.01041	-0.02036
Variance	0.005863	0.005373
Observations	69	69
Pearson Correlation	0.177282	
Hypothesized Mean Difference	0	
df	68	
t Stat	0.859538	
P(T<=t) one-tail	0.196532	
t Critical one-tail	1.667572	
P(T<=t) two-tail	0.393064	
t Critical two-tail	1.995469	

From the results of Table 19, it can be seen that the mean of A of AB-share CARs is greater than B of AB-shares' and t-statistic is 0.27, which is not significant at 0.05 level of significance. The results do not support that the earnings response of the B of AB-shares for the "Good News" announcements is greater than A of AB-shares' for the Shenzhen market and therefore $H2B_1$ should be rejected.

TABLE 19: MATCHED PAIRS T-TEST FOR SHENZHEN GOOD NEWS ANNOUNCEMENTS CRS 2001-2003 (A OF AB : B OF AB) T-TEST: PAIRED TWO SAMPLE FOR MEANS

	A of AB	*B of AB*
Mean	-0.005325	-0.007812
Variance	0.006032	0.007966
Observations	77	77
Pearson Correlation	0.570104	
Hypothesized Mean Difference	0	
df	76	
t Stat	0.279601	
P(T<=t) one-tail	0.390272	
t Critical one-tail	1.665151	
P(T<=t) two-tail	0.780543	
t Critical two-tail	1.991673	

Table 20 shows that there is a significant difference between the means, P=0.007 at the 0.05 level of significance. However, the mean of B of AB-share CARs is less than A of AB-shares'. The results do not support $H2C_1$ which should be rejected.

Table 20: Matched Pairs t-Test For Shanghai Bad News Announcements CRs 2001-2003 (A of AB : to B of AB) - t-Test: Paired Two Sample for Means

	A of AB	**B of AB**
Mean	-0.04971	-0.07324
Variance	0.009763	0.006173
Observations	43	43
Pearson Correlation	0.328695	
Hypothesized Mean Difference	0	
df	42	
t Stat	1.482536	
P(T<=t) one-tail	0.072831	
t Critical one-tail	1.681952	
P(T<=t) two-tail	0.145663	
t Critical two-tail	2.018082	

Table 21 shows that the mean of A of AB-share CARs is greater than B of AB-shares' and t-statistic of 2.22 is significant at P of 0.016. The results do not support $H2D_1$ which should be rejected.

TABLE 21: MATCHED PAIRS T-TEST FOR SHENZHEN BAD NEWS ANNOUNCEMENTS CRS 2001-2003 (A OF AB : B OF AB) - T-TEST: PAIRED TWO SAMPLE FOR MEANS

	A of AB	*B of AB*
Mean	-0.028076	-0.056928
Variance	0.012165	0.008856
Observations	35	35
Pearson Correlation	0.729561	
Hypothesized Mean Difference	0	
df	34	
t Stat	2.226739	
P(T<=t) one-tail	0.016347	
t Critical one-tail	1.690924	
P(T<=t) two-tail	0.032694	
t Critical two-tail	2.032244	

The results of the post 2001 period suggest that the effect of international accounting standards is not significant. The results do not support that the earnings of the B-shares based on IAS, in contrast to Chinese GAAP, are more value-relevant due to increased information disclosures.

TEST RESULTS FOR HYPOTHESIS THREE

In the segmented market up to 2001, the earnings responses of the B-share of an AB-Share company should be greater than the A-Share of an AB-Share company in the Chinese markets. Hypothesis Three tests whether the Chinese stock markets are segmented for the pre 2001.

Table 22 shows that the mean of B of AB-share CARs is greater than A of AB-shares' and t-statistic is -4.5, which is significant at 0.01 level of significance. The results support that the earnings response of the B of AB-shares for "Good News" announcements is greater than A of AB-shares' for the Shanghai market and therefore $H3A_0$ should be rejected.

TABLE 22: MATCHED PAIRS T-TEST FOR SHANGHAI GOOD NEWS ANNOUNCEMENTS CRS 1999-2000 (A OF AB : TO B OF AB) - T-TEST: PAIRED TWO SAMPLE FOR MEANS

	A of AB	***B of AB***
Mean	0.012121	0.152787
Variance	0.006884	0.037521
Observations	43	43
Pearson Correlation	0.088384	
Hypothesized Mean Difference	0	
df	42	
t Stat	-4.52444	
P(T<=t) one-tail	2.45E-05	
t Critical one-tail	1.681952	
P(T<=t) two-tail	4.91E-05	
t Critical two-tail	2.018082	

Table 23 shows that the mean of B of AB-share CARs is greater than A of AB-shares. The result is significant at p of 0.001. The results support that the earnings response of the B of AB-shares is greater than A of AB-shares' for the Shenzhen market and therefore $H3B_0$ should be rejected.

TABLE 23: MATCHED PAIRS T-TEST FOR SHENZHEN GOOD NEWS ANNOUNCEMENTS CRS 1999-2000 (A OF AB : TO B OF AB) - T-TEST: PAIRED TWO SAMPLE FOR MEANS

	A of AB	*B of AB*
Mean	0.017977	0.136059
Variance	0.015063	0.078155
Observations	54	54
Pearson Correlation	0.319447	
Hypothesized Mean Difference	0	
df	53	
t Stat	-3.24969	
P(T<=t) one-tail	0.001005	
t Critical one-tail	1.674116	
P(T<=t) two-tail	0.002009	
t Critical two-tail	2.005746	

Table 24 shows that the mean of B of AB-share CARs is greater than A of AB-shares' and t-statistic is -2.05, which is significant at P of 0.02. The results support that the earnings response of the B of AB-shares for "Bad News" announcements is greater than A of AB-shares' for the Shanghai market and therefore $H3C_0$ should be rejected.

TABLE 24: MATCHED PAIRS T-TEST FOR SHANGHAI BAD NEWS ANNOUNCEMENTS CRS 1999-2000 (A OF AB : TO B OF AB) - T-TEST: PAIRED TWO SAMPLE FOR MEANS

	A of AB	***B of AB***
Mean	0.043913	0.123235
Variance	0.009348	0.032743
Observations	27	27
Pearson Correlation	0.054676	
Hypothesized Mean Difference	0	
df	26	
t Stat	-2.05628	
P(T<=t) one-tail	0.024961	
t Critical one-tail	1.705618	
P(T<=t) two-tail	0.049922	
t Critical two-tail	2.055529	

Table 25 shows that the mean of B of AB-share is greater than A of AB-shares' which is not significant at 0.05 level (p =0 .17). The results support that the earnings response of the B of AB-shares is greater than A of AB-shares' for the Shenzhen market and therefore $H3D_1$ is rejected.

TABLE 25: MATCHED PAIRS T-TEST FOR SHENZHEN BAD NEWS ANNOUNCEMENTS CRS 1999-2000 (A OF AB : TO B OF AB) - T-TEST: PAIRED TWO SAMPLE FOR MEANS

	A of AB	***B of AB***
Mean	-0.00297	0.043509
Variance	0.02015	0.037884
Observations	14	14
Pearson Correlation	0.452308	
Hypothesized Mean Difference	0	
df	13	
t Stat	-0.95667	
P(T<=t) one-tail	0.178093	
t Critical one-tail	1.770933	

P(T<=t) two-tail	0.356185
t Critical two-tail	2.160369

The results of the pre 2001 clearly indicate that the earnings response of the B of AB-shares is greater than A of AB-shares' for the both Shanghai and Shenzhen markets, and suggest that the Chinese stock markets were segmented for the pre 2001.

TEST RESULTS FOR HYPOTHESIS FOUR

Hypothesis Four tests whether market segmentation will not exist for the post 2001 by examines that the earnings response for the B of AB-shares will be the same as the A of AB-shares as both have the same quality of governance.

The results of the stage One for the post 2001 show that CRs of good news and bad news announcements are significantly different from zero for the Shanghai and Shenzhen markets. The results of the stage One for the post 2001 are presented in Table 5-14, Table 5-15, Table 5-16 and Table 5-17 in Section 5.3.2.

The results of matched pairs for Hypothesis Four are also shown in Table 18, Table 19, Table 20 and Table 21. The results of these tables show that the earnings responses of the A of AB-shares and the B of AB-shares are not the same for both Shanghai and Shenzhen markets. The results do not support that that the earnings response for the B of AB-shares will be the same as the A of AB-shares as both have the same quality of governance. Therefore, $H4A_{1,}$ $H4B_1$, $H4C_1$ and $H4D_1$ should be all rejected. These results suggest that the Chinese stock markets remained segmented after the relaxation of restrictions on purchase of B-shares by domestic investors in 2001.

SUMMARY OF THE FINDINGS AND CONCLUSIONS

As stated in Section 5-1, the findings of the descriptive statistics are summarised as follows.

(a) The descriptive statistics presented in this chapter show the relaxation of B-share trading restriction did not eliminate the A-shares price premiums, but it reduced from a level around 80% to 50% in both Shanghai and Shenzhen markets. This finding is consistent with the finding of Mei et al.(1999). The implication of this finding suggests that the Chinese markets remain segmented after the regulation change in 2001. This finding is also consistent with the results of Hypotheses Four stated in Section 5.3.5.

(b) The impact of relaxation of B-share trading restriction in 2001 was significant in both Shanghai and Shenzhen markets. B-shares' stock price and PE ratio were boosted in 2000. For example, Shanghai B of AB sample mean stock price increased by 290% , Shenzhen B of AB sample mean stock price increased by 78%, Shanghai A of AB sample mean share

price increased by 19% and Shenzhen A of AB sample mean share price increased by 10% in 2000.

(c) Mixed results were found for the test of Hypothesis One(a) when controlling for good news and bad news and for the market in which the shares are traded. For the Shanghai Market, there is no significant difference between the CARs of the A of AB shares compared with those of the A shares while there is a significant difference for the "bad news" portfolio. Conversely, the Shenzhen marker shows a significant differences between the CARs of the A of AB shares compared with those of the A shares for "good news" announcements but no significant difference for "bad news" announcements. The results of Hypotheses One(a) suggest pre 2001 period are inconclusive.

(d) For the post 2001 period, the CARs for the A of AB shares are not significantly greater than those of the A shares for Shanghai and Shenzhen markets. The effect of these structural factors for the pre 2001 period is greater than the effect for the post 2001. However, these effects are not significant. The findings do not support that a better governance structure of A of AB shares will result in significantly greater abnormal returns.

(e) The results of Hypothesis Two indicate that the effect of international accounting standards is not significant for the post 2001. The results do not support that the earnings of the B-shares based on IAS, in contrast to Chinese GAAP, are more value-relevant due to increased information disclosures.

(f) The findings of Hypothesis Three and Four indicate that the Chinese stock markets were segmented before the relaxation of restrictions on purchase of B-shares by domestic investors in 2001 and they remained segmented after the regulation change in 2001.

The results show that the impact of governance structure, board independence, share ownership, and audit quality are not significant for both the pre 2001 period and the post 2001 period. The effect of these structural factors for the pre 2001 period is greater than the effect for the post 2001. However, these effects are not significant. The findings do not support that a better governance structure of A of AB shares will result in greater returns.

The effect of international accounting standards is not significant for the post 2001. The results do not support that the earnings of the B-shares based on IAS, in contrast to Chinese GAAP, are more value-relevant due to increased information disclosures.

Our results also show that the market segmentation in the Chinese stock markets that existed pre 2001 still persists for the post 2001.

The overall conclusion is that the use of international governance standards makes no significant difference to the market's reaction to accounting information. Contrary to expectation, there is no statistical support for the superior reliability of earnings information provided using International Accounting Standards. One explanation for the results is that the security provided by the government's involvement in the control of management. This situation may be equally effective in mitigating the agency costs normally accepted as existing in the manager / shareholder relationship.

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